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REVIEW OF THE 1982 JAPANESE ECONOMY

Summary

The Japanese economy slowed down last year, dashing hopes for a quick recovery, and the government revised its economic forecast twice -- from 5.2 percent to 3.4 percent and again to 3.1 percent. Although housing expenditures were expected to boost economic growth, residential construction actually declined. Meanwhile, a slump in exports resulting from the worldwide recession further depressed economic growth. Private capital spending fell, as a deterioration of corporate profits forced up the unemployment rate to 2.48 percent -- the highest level since 1956. Only personal consumption showed a firm gain. With the government unable to employ fiscal policy because of the large budget deficit, and the Bank of Japan reluctant to cut the discount rate and risk further yen depreciation, the economy stagnated for another year.

Fiscal 1982 Projections

The government of Japan initially forecast that real growth would recover to 5.2 percent in fiscal 1982 (April 1, 1982 to March 31, 1983), with domestic and external demand contributing 4.1 percentage points and 1.1 percentage points, respectively. In the first category, personal consumption was to pick up by 3.9 percent, housing investment by 10.4 percent, and private capital investment was expected to grow 7.7 percent. Efforts to resolve the budget deficit were continued, but the adoption of policies to spur domestic demand, particularly housing investment, was expected to improve the performance of both domestic and external sectors. Prices were projected to hold steady, with modest increases in consumer prices (4.7 percent) and wholesale prices (3 percent).

In view of the tremendous pressure on Japan to pare its trade surplus, the government announced that measures would be taken to assure harmonious economic relations by further opening the Japanese market, facilitating imports, avoiding excessive

concentration of exports of specific products and encouraging industrial cooperation. But trade frictions proved unresponsive to these blandishments and declines in production were widespread. Despite an unexpectedly strong surge in personal consumption, the economy recovered very slowly, plagued by a drop in exports corresponding to the stagnant world economy, and weak housing investment even though more liberal loan and tax policies favoring home ownership were in place. As a result, the number of job openings appears to be tightening and certain industries are showing structural problems.

GNP Growth By Sector

Personal Consumption — After consumer demand stagnated in 1980-81 as a result of a decline in real income, it rose 1.0 percent in the January-March quarter, 2.3 percent in the second quarter, 0.4 percent in the third quarter and 1.5 percent in the final quarter of 1982. Household spending also rose a surprising 2.7 percent — the first real growth in three years, after sinking 0.6 percent in 1980 and 0.8 percent in 1981. This recovery can be traced to an increase in real income and a sharp drop in inflation. Real income of salaried households averaged ¥393,000 (about $1,660) a month in 1982, a 3-percent increase in disposable income after declines of 1.4 percent and 1 percent in 1980 and 1981. Consumer prices held at 2.7 percent, compared with increases of 8.0 percent in 1980 and 4.9 percent in 1981, and personal consumption expenditures remained at a high level.

The salient point in consumer behavior last year was the extent to which spending for services increased, as shown in total supermarket sales. Supermarkets registered the smallest increase on record — 1.6 percent in 1982; the elasticity of supermarket sales to household expenditures has been 1.0 in the last five years, but declined to 0.84 in 1981 and will drop to almost 0.5 in 1982. Even if unemployment continues at the same level, the deceleration of inflation and gains in real income suggest that the rise in consumption will continue for some time.

Housing Investment — To the consternation of government forecasters, private residential construction declined by 1.6 percent in 1982 despite hopes that a 14-percent increase to 1.3 million housing starts would materialize. Deterred by the high price of land, new housing starts actually slipped 0.5 percent from the previous year to 1.14 million units — the fourth consecutive annual decline. The lag was most evident in apartment construction, the weakest element of which, condominiums, slowed by 24.2 percent.

But some improvement is expected. A survey by the National Land Agency showed land prices up an average 5.1 percent in 1982, compared with the 8.3-percent increase in 1981. As long as the price increase is below mortgage interest rates (presently averaging 8.34 percent), and below the return on alternative investments such as the 5.75-percent interest on one-year time deposits, speculative demand in real estate will be dampened because high capital gains will no longer be assured. With consumer demand high and a slowing of the price increase for land, this sector should begin to strengthen. In addition, stable construction and labor costs and an expected decline in mortgage interest rates will stimulate demand and contribute to an increase in new construction and housing rehabilitation projects.

Private Capital Investment — Real capital spending slowed to 0.1 percent in the first quarter of 1982, 0.5 percent from April to June, 0.6 percent in the third quarter and minus 0.2 percent in the final quarter of the year. Capital spending in plant and equipment by large companies was firm in 1982, while business investment by small- and medium-scale firms was stagnant, a result of depressed business conditions and a

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contraction in export orders. In raw material industries, which have been adjusting to the rising costs of oil by investing heavily in energy-saving equipment and rationalization, capital spending has been increasing since 1976. However, the decline in exports that began in the latter half of 1981 has lessened incentives for capital spending in raw material, processing and assembling industries. The current year promises little improvement if the economy does not rebound.

Inventory Liquidation — Inventories in raw-material industries were worked down by the third quarter, but in the processing industries and in steel fabrication — both of which are trade-dependent, inventories increased. Inventories on a GNP basis have been declining since 1975, with the exception of 1982's fourth quarter, largely because of retrenchment, better inventory control, and the development of the service sector. Inventory movement, though, has been low enough to depress the economy by reducing production activity, which last year rose only 1.1 percent. Inventories of final products, however, increased in 1982, because production cuts in export-related industries came too late to compensate for the rapid decline in exports.

Government Expenditures — While total spending for public works in the FY 1982 budget was held at the same amount as in the previous year's budget, the government decided in April to advance to the first half of the fiscal year 77.3 percent of the whole year's appropriation. In October, the government instituted a $7.7-billion economic recovery package, including a boost in public works spending.

External Sector

Japan's exports began to decline in 1981 and were far from robust in 1982 despite the yen's depreciation. Exports to all regions, including the oil-producing countries, fell victim to the worldwide recession, abundant inventory stocks, and trade frictions with the United States and European Community (EC) countries. A number of items were subjected to some kind of export restraint, including automobiles, motorcyles, color televisions, video tape recorders, machine tools, textiles and steel products. Export totals for 1982 slid to $138.4 billion, an 8.7-percent decline. By region, exports to the United States totaled $36.3 billion, down 5.9 percent; and to the EC $17.1 billion, down 9.6 percent. An official of the Ministry of International Trade and Industry (MITI) said that he considered fluctuations in foreign-exchange rates responsible to some extent for the decline in exports, noting that recovery will depend on more stability in the money markets.

The effects of slowed industrial production and residential construction were apparent in the reduced demand for raw materials and fuel in 1982. In addition, increases in imports in the second half of 1981 pushed up raw material inventories so that stocks of oil and lumber were excessive. With the yen sinking throughout much of the year, moreover, domestic goods enjoyed a hefty competitive edge over their imported rivals. And finally, imports of gold — which had increased rapidly in 1981 — fell 7.9 percent in 1982.

Imports from the United States fell 4.5 percent during the year to $24.2 billion, reducing the bilateral trade surplus to $12.2 billion, down from the $13.3-billion peak reached in 1981. Imports from the EC also fell 11.6 percent to $7.6 billion resulting in a trade surplus of $9.5 billion (compared with the high of $10.3 billion in 1981).

Japan's global trade surplus for 1982 on a customs clearance basis (exports f.o.b. and imports c.i.f.) dropped to $6.9 billion from $8.7 billion a year earlier. The current account in the international balance of payments hit $6.9 billion, compared with $4.8

billion in 1981, due to a smaller deficit in services and unilateral transfers. The reduction to $11.3 billion, down from 1981's $15.2-billion level, was made possible by a $2.6-billion rise in investment returns including earnings on direct overseas investments and interest and dividend receipts. The long-term capital outflow, propelled by a variety of economic factors, shot to a record $15 billion, as against last year's $6.4 billion.

Fiscal Policy

Concern that an increase in government spending would worsen the deficit and require additional bond borrowing led the government to propose an austere budget. The measure limited the increase to 6.2 percent (including non-discretionary debt service and payments to local governments), although overall discretionary expenditures actually rose by only 1.8 percent. But peremptory calls for stimulative fiscal measures in the following months essentially forced the government in October to adopt a recovery package, including measures to boost public works funds, assist small businesses, and take action to stimulate employment and construction. These measures, which were expected to spur the GNP to a 3.4-percent level, were authorized but not actually funded. When the supplementary budget — actually a revision — was passed, there was no increase, although there was some shifting to provide funds for public works. The original budget was, in fact, cut overall to bring expenses in line with unexpectedly low tax revenues.

Monetary Policy

Quantitative controls on lending through window guidance were relaxed in 1982, but stagnant demand essentially precluded a positive impact. A discount-rate cut in December 1981 to 5.5 percent lowered interest rates in the first few months of the year, but the Bank of Japan began guiding short-term interest rates to a higher level in order to prevent further yen depreciation produced by the interest differential between the United States and Japan. Both the rise in short-term interest rates and the large issues of public bonds supported the yields of long-term bonds. And with inflation declining, real interest rates were kept at a high level, diminishing the effects of monetary relaxation compared with the response to the 1977-78 relaxation. In sum, the effects of fiscal-monetary policy in 1982 were negligible because the authorities held down growth in public expenditures and because interest rates remained at a relatively high level to control the yen's depreciation.

Price Movements

Wholesale prices were up 2.5 percent in the first quarter (over the same period in the previous year), and subsided thereafter to average 1.8-percent above the previous year. The effect of yen depreciation accounted for an increase in wholesale prices of 2.2 percent. Weak export shipments and high inventories also caused export prices to decline by 3.5 percent (apart from the effects of yen depreciation), particularly in textiles, metal products and electrical equipment. Import prices also fell 2.7 percent in value, largely due to low grain prices. Thus, consumer prices registered a low 2.7-percent increase — owing to stable prices for manufactured products, low produce prices and moderate utility rates. Moreover, wholesale and consumer price inflation will probably be even lower in 1983 because of the relatively low wage increases.

Labor

The unemployment rate reached a peak of 2.48 percent in June and in October, and remained at a high level through 1982 in response to cyclical and structural factors. Lower economic growth and the labor supply situation, including more women in the labor force, unemployment of older workers, and the changing industrial structure worked to hike the unemployment figures.

Outlook for 1983

The official forecast for Japan's gross national product in real terms is 3.4 percent in FY 1983, with domestic and external demand contributing 2.8 percentage points and 0.6 percentage points, respectively. Economists differ, however, on the proper interpretation of present conditions. The Ministry of Finance (MOF) is convinced that the signs of economic recovery are strong. Personal consumption, it notes, has been firm, with increases in purchases of durable goods, housing and expenditures for services. This pickup, it says, has speeded inventory adjustment and will benefit corporate profits in the first half of FY 1983. But this view may stem more from its political orientation, since the MOF is campaigning against fiscal interventions such as an income-tax cut and additional expenditures for public works.

The governor of the Bank of Japan, Haruo Maekawa, has said that while the Japanese economy has bottomed out, he does not expect a rapid recovery. This is the first time the governor has suggested this scenario, and he cited signs of a recovery in exports, some progress in inventory adjustments, and declining oil prices to support his view. However, he did acknowledge that the economic recovery depended on an expansion in the U.S. economy and on a solution to trade restrictions.

Economic Planning Agency (EPA) economists sound a more cautious note in the agency's monthly economic report. The bright spots in the economy — housing investment, consumer confidence and inventories — are not strong enough to provide much momentum, it warns. There is some pressure to go ahead with an income-tax cut and a stimulative monetary policy, it suggests, including an official discount-rate cut as discussed in the economic stimulus package.

The optimists rely on improving exports and falling inventories, and pin their hopes on business confidence spurred by declining oil prices and a growing recovery in the United States and Europe. The pessimists see problems in sluggish capital spending and personal consumption due to low wage increases. The final course of the economy will depend on the interaction of these developments as well as on an easing of international trade relations in 1983.

For further information, contact Yoshio Nakamura.

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Major Japanese Economic Indicators, FY 1981 and FY 1982

(percent change over previous year or quarter)

	1981				1982					
	January-March	April-June	July-September	October-December	January-March	April-June	July-September	October-December	1981	1982
Real Gross National Product[1]	¥194.6	¥196.9	¥198.5	¥198.0	¥198.8	¥202.6	¥204.5	¥205.4	¥197.1	¥202.9
	0.9%	1.2%	0.9%	-0.3%	0.4%	1.9%	0.9%	0.4%	3.8%	3.0%
Personal Consumption Spending	-0.5	0.6	0.2	0.8	1.0	2.3	0.4	1.5	0.5	4.2
Private Residential Construction	2.1	2.1	-3.0	-1.4	-1.5	0.9	0.6	7.4	-2.6	-1.0
Private Fixed Nonresidential Investment	2.1	1.4	-0.3	1.2	0.1	0.5	0.6	-0.2	5.6	1.9
Change in Business Inventories	-2.6	-19.3	-44.5	158.1	-20.1	-7.7	-21.0	-17.3	-22.4	-11.9
Government Current Expenditures	2.4	-0.3	-0.8	1.2	0.6	1.5	0.8	0.4	4.6	3.5
Government Fixed Investment	3.8	-0.9	4.5	-5.4	-4.3	4.7	5.5	-4.3	5.3	0.7
Net External Sector	3.4	14.9	13.9	-15.7	3.9	0.7	4.9	1.4	52.5	3.7
Exports of Goods and Services and Factor Income Received	4.1	6.3	5.8	-3.2	1.5	-0.6	2.6	-3.2	15.9	3.3
Imports of Goods and Services and Factor Income Paid	4.4	3.1	2.4	2.6	0.6	-1.1	1.6	-5.1	5.5	3.1
Industrial Production	1.0	0.5	2.1	2.0	-1.0	-1.6	1.7	-0.6	3.1	1.1
Wholesale Prices*	-0.7	1.1	1.3	-0.3	0.4	0.3	1.0	-0.1	1.4	1.8
Wholesale Prices**	4.1	0.2	1.0	1.5	2.5	1.7	1.4	1.6	---	---
Consumer Prices*	0.9	0.5	0.9	1.2	0.3	0.2	1.0	0.7	4.9	2.7
Consumer Prices**	6.6	4.9	4.2	4.0	3.1	2.5	2.7	2.3	---	---
Current Balance[2]	$-2,076	$1,455	$3,531	$1,860	$-912	$2,582	$2,924	$2,302	$4,770	$6,896
Long-Term Capital[2]	$2,592	$-5,709	$-1,213	$-2,119	$-5,805	$-4,569	$-4,652	$19	$-6,449	$-15,007

[1]In trillions of yen.
[2]In millions of dollars.
*Compared to previous period.
**Compared to same quarter of previous year.

Sources: Economic Planning Agency, Ministry of International Trade and Industry; Prime Minister's Office; Bank of Japan.